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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

IN THE MATTER OF PITTSBURGH RAILWAYS COMPANY, Debtor

NO. 359

PHILADELPHIA COMPANY, Petitioner,

v.

JULES GUGGENHEIM ET AL.

NO. 360

PHILADELPHIA COMPANY, Petitioner,

v.

CITY OF PITTSBURGH

NO. 361

PHILADELPHIA COMPANY, Petitioner,

v.

HORACE F. BAKER and JOHN A. BLATTIE, Protective Committee for Southern Traction Company 50-Year First Mortgage and Collateral Trust 5% Gold Bonds

PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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INDEX

	PAGE
Opinions Below	2
Jurisdiction	2
Statutes Involved	3
Questions Presented	4
Statement	5
Reasons for Granting the Writs	17
Conclusion	27

Cases Cited

Ambridge Borough v. Philadelphia Company, 283 Pa. 5; 129 A. 67 (1925) 20

American Brake Shoe & Foundry Co. v. New York Railways Co., 293 F. 633 (2 Cir., 1923) 22

Chicago, Milwaukee, St. Paul & Pacific Railroad Company, 239 I. C. C. 485 (1940) 21

In re Chicago Rapid Transit Co., 129 F. 2d 1 (7 Cir., 1942) 22

Com. ex rel. Margiotti v. Union Traction Co., 327 Pa. 497; 194 A. 661 (1937) 20

Dalton Street Railway Co. v. Scranton, 326 Pa. 6; 191 A. 133 (1937) 20

Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R. Co., 318 U.S. 523, 63 S.Ct. 727 (1943) 21

Heiser v. Woodruff, ... U.S. ...., 66 S. Ct. 853 (1946) 26

Palmer v. Connecticut Railway and Lighting Co., 311 U.S. 544, 61 S.Ct. 379 (1941) 22, 25

Citations.

PAGE

Pennsylvania Steel Co. v. New York City Ry. Co., 198 F. 721 (2 Cir., 1912) 22

Philadelphia Co. v. Dipple, 312 U.S. 168, 61 S.Ct. 538 (1941) 5, 13, 18

In re Reorganization of Pittsburgh Railways Co., 111 F. 2d 932 (3 Cir., 1940) 16

Second Avenue Traction Company v. United Traction Company of Pittsburgh, 328 Pa. 257, 195 A. 25 (1937) 11, 19

Smith v. Hoboken R. R. Warehouse & S. S. Conn. Co., ... U.S. ...., 66 S. Ct. 947 (1946) 22

Third National Bank v. Lehigh Valley Coal Co., 353 Pa. 185; 44 A. 2d 571 (1945) 20

Thompson v. Texas Mexican Ry. Co., 324 U.S. 838 66 S.Ct. 937 (1946) 22

Statutes Cited

Bankruptcy Act, Chapter X:

Sec. 111, 11 U.S.C.A. 511 3

Sec. 115, 11 U.S.C.A. 515 3

Sec. 216, 11 U.S.C.A. 616 3

Other Citations

Constitution of the United States of America, Art. I, Sect. 8 23

"Railroad Leases and Reorganization", 49 Yale Law Journal 626 (Meck and Masten, 1940) 26

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PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Philadelphia Company, owner of all of the capital stock of the above-named debtor, the principal creditor of the debtor, and an appellee in the Circuit Court of Appeals, prays that writs of certiorari issue to reverse the orders of the United States Circuit Court of Appeals for the Third Circuit entered in the above-entitled case.

OPINIONS BELOW

The Report of the Special Master appears at pages 604 to 838 of the record. The opinion of the District Court for the Western District of Pennsylvania appears at pages 133 a to 151 a of the record and is reported at 60 F. Supp. 600. The opinion of the Circuit Court of Appeals is printed at pages 939 to 952 of the record and is reported at 155 Fed. 2d. 477.

The orders of the Circuit Court of Appeals were entered on May 7, 1946 (R. 952-954). A petition for clarification of the Circuit Court's opinion and orders was filed on June 11, 1946 by the Trustee of the debtor. This petition, which appears at pages 955 to 964 of the record, was denied without opinion on June 28, 1946 (R. 970).

JURISDICTION

The jurisdiction of the Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 (28 U.S.C.A. 347). Section 240(a) is rendered applicable to appeals in bankruptcy reorganization proceedings by Section 121 of Chapter X (11 U.S.C.A. 521) which in turn makes reference to the Bankruptcy Act (cf. Section 24(c); 11 U.S.C.A. 47).

STATUTES INVOLVED

Chapter X, Bankruptcy Act of 1938:

Sec. 111. "Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located." (11 U.S.C.A. 511)

Sec. 115. "Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature." (11 U.S.C.A. 515)

Sec. 216. "A plan of reorganization under this chapter

* * * * * * * *

(2) may deal with all or any part of the property of the debtor;" * * * (11 U.S.C.A. 616)

QUESTIONS PRESENTED

In a proceeding instituted under Section 77B of the Bankruptcy Act, where a petition for reorganization has been filed by a street railway company which has operated the properties of so-called underlier or lessor street railway companies, some of which are non-affiliates and others are subsidiaries or affiliates of the debtor; and where such operations have been conducted by the debtor for the most part pursuant to operating agreements which have been held by the Supreme Court of the State to pass no title to the debtor; and where none of the underliers is the subject of a petition for reorganization, the questions are:

1. Does the Court have jurisdiction to treat the property of the underliers as "property of the debtor" within the meaning of the Bankruptcy Act, and to include such property in a plan of reorganization contemplating the merger and unification of all of the companies?

2. Does the court have jurisdiction (in the words of the Circuit Court of Appeals, R. 943) to pull "into the organization, willy-nilly" the lessor corporations of the debtor?

3. May the Court ignore corporate entities as between the debtor and its lessor corporations when the latter are either (a) publicly controlled non-affiliates of the debtor, or (b) affiliates of the debtor, i.e. subsidiaries of a common parent, or (c) subsidiaries of the debtor, the voting control of which has passed out of the debtor into an indenture trustee?

4. May the property of lessor street railway companies, operated under operating agreements which are

valid under state law and which have been held by the Supreme Court of the State to pass no title to the debtor, be administered as part of the property of the debtor?

5. May the Court bring into the reorganization proceedings and administer their property as property of the debtor, underlier or lessor corporations as to which there is no finding of insolvency or inability to pay their debts as they mature?

6. May the Court administer as though it were property of the debtor the property of the lessor or underlier corporations of the debtor, when the Supreme Court of the United States has declared in a prior case arising out of the same reorganization proceedings that (in the words of the prior case, *Philadelphia Co. v. Dipple,* 312 U.S. 168, 173) "none of the lessor or underlier companies is in reorganization"?

STATEMENT

1. The Nature of the Proceeding

This case arises out of the corporate reorganization proceedings of Pittsburgh Railways Company, and presents the problem of the extent to which the reorganization court may assume jurisdiction over, and deal with in a plan of reorganization, the lessor or underlier companies of the debtor, where none of the underliers has filed, or has had filed against it, a petition for reorganization.

The subject of the present litigation is a petition by the City of Pittsburgh (R. 40 a to 83 a) which seeks to have the Bankruptcy Court assume jurisdiction to deal

with the property of the underliers as fully as if either they were the properties of the debtor or as if the underliers were being reorganized in this proceding (Cf. R 814; SMR 1051).[1] The prayer of the City's petition (R. 75 a) is as follows:

> "(1) That this Court forthwith assume and exercise jurisdiction over all the properties and assets, or interests therein, of each of the Underliers, or so much thereof as may be actually or constructively in the custody of this Court; and hear and determine, as part of plan hearings under Section 169 of the Bankruptcy Act, the respective substantive rights, priorities, liens, claims and interests of all the creditors and stockholders of all the Underliers, as persons having claims against or interests in the Debtor or its properties or portions thereof, taking cognizance of all rights and equities existing in favor of any creditors or stockholders as against any others; and classify such creditors and stockholders for the purpose of the plan and its acceptance, according to the nature of their respective claims and interests."

The City's petition was considered in an exhaustive report by a Special Master, who recommended its dismissal (R. 837). The District Court adopted the Master's findings and recommendation (R. 148 a). On appeal

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[1] The abbreviation "R" followed by a numeral, is used herein to refer to *pages* of the Transcript of Record.

The abbreviation "SMR", followed by a numeral, is used herein to refer to *paragraphs* of the Special Master's Report, which appears at pages 604 *et seq.* of the Record.

[1], the Circuit Court likewise adopted the Master's findings, characterizing his report as "full and complete and most carefully done" (R. 943), but reversed the District Court as a matter of law (R. 952).

2. The Companies Involved

Pittsburgh Railways Company is the sole debtor in the case. On May 10, 1938, it filed a voluntary petition for reorganization under Section 77B of the Bankruptcy Act. For many years prior thereto, it had possessed and used the properties of numerous underlier street railway companies and had operated those properties, in connection with its own, as a unified railway system in Pittsburgh, Pennsylvania and surrounding territory. Of the total track mileage of 530 track miles operated by it, Pittsburgh Railways Company owns 34 (R. 659, SMR 201, 202). The remainder of the trackage is owned by lessor or underlier companies.

Philadelphia Company owns all of the stock of Pittsburgh Railways Company. Philadelphia Company also owns the stock of corporations furnishing gas and elec-

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[1] Three separate appeals were taken to the Circuit Court of Appeals, bearing the following numbers in that Court:

Jules Guggenheim, et al.— No. 8964

City of Pittsburgh, et al.— No. 8967

Horace F. Baker and John A. Beattie, Protective Committee, for Southern Traction Company 50-Year First Mortgage and Collateral Trust 5% Gold Bonds—No. 8996

Although a single opinion was written, the Circuit Court entered a separate order of reversal on each appeal.

tric service in the City of Pittsburgh and surrounding territory, and is a public utility holding company subject to the Public Utility Holding Company Law. It owns the stock of some of the underlier or lessor corporations of Pittsburgh Railways Company (R. 615, SMR 17, 25) Other underliers, however, are publicly controlled.

The underlier companies may be classified according to their stock relationship to the debtor, as follows (R. 650, SMR 158; R. 846):

13 *publicly controlled companies* having a total of 132 miles of track. A majority of the stock of each of these companies is and always has been controlled by public holders having no connection with Philadelphia Company or Pittsburgh Railways Company.

10 *affiliates of Pittsburgh Railways Company* having a total of 88 miles of track. These companies are subsidiaries of Philadelphia Company, but not of Pittsburgh Railways Company.

26 *subsidiaries of Pittsburgh Railways Company,* having a total of 251 miles of track.

3. Unified Operation, 1902 - 1938

The laws of Pennsylvania have long authorized the execution of leases and operating agreements among street railway companies (R 826, SMR 1072) with no suggestion that such leases would amount to conveyances, or would result in a destruction of the corporate entities of lessor and lessee. Pursuant to this statutory authority, all of the leases in the present case were executed, most of them prior to the time when Pittsburgh Railways Company or Philadelphia Company had any

interest in the street railway business (cf. R. 639, SMR 92).

Immediately prior to 1902 there were six separately operated street railways systems in Pittsburgh and vicinity (R. 632, SMR 62 *et seq.*). Philadelphia Company had recently acquired stock control of three of these, namely:

1. Pittsburgh Railways Company (then called Southern Traction Company)
2. Consolidated Traction Company
3. United Traction Company of Pittsburgh.

The three remaining systems were, and still are, publicly controlled (R. 650, SMR 158). These are the so-called "guaranteed" underliers (R. 609, SMR 1), namely:

4. Monongahela Street Railway Company
5. The Suburban Rapid Transit Street Railway Company
6. Pittsburgh and Birmingham Traction Company.

Each of these six companies had brought together for unified operation the property of lessor or underlying companies. The operating company was the owner of a majority or all of the stock, directly or indirectly, of its lessors, except that Consolidated Traction Company operated the property of four lessor companies which were then, and still are, publicly controlled (R. 650, SMR 158). These are the so-called "unguaranteed" underliers (R. 609, SMR 1) namely:

The Citizens Traction Company and subsidiary, and Allegheny Traction Company and subsidiary.

As of January 1, 1902, long-term leases were executed by the so-called "guaranteed" underliers to United and Consolidated. Separate leases ran from Monongahela and Suburban to Consolidated, and a lease ran from Birmingham to United (R. 641, SMR 106, 109). Philadelphia Company, by guaranty attached to each of the leases, guaranteed the payment of the rental and the faithful performance of the covenants of the lessees (R. 641, SMR 111). Hence the description of Monongahela, Suburban and Birmingham as "guaranteed" underliers.

Consolidated (thus enlarged by leases from Monongahela and Suburban) and United (thus enlarged by lease from Birmingham) then executed separate operating agreements effective January 1, 1902 with Pittsburgh Railways Company (R. 654, 655; SMR 164, 166). Pursuant to these operating agreements all of the properties in the Consolidated Traction and United Traction systems came into the possession of Pittsburgh Railways Company for operation.

These two systems comprise more than 75% of the property of the underliers covered in the City's petition, their mileage being as follows (cf. R. 665 *et seq.;* SMR 205, 206; R. 846):

Consolidated and lessors—	195 miles.
United and lessors—	209 miles.

The operating agreements, pursuant to which the properties of Consolidated and United have been operated by Pittsburgh Railways Company since 1902, were for an original term of five years, terminable on 3 months' notice (R. 654, SMR 164, 166). They provide

that Pittsburgh Railways Company shall "maintain and operate " [1] the property.

In addition to the operating agreements, Pittsburgh Railways Company had received in 1901 a long-term lease covering 49 miles of track from its subsidiary, West End Traction Company (R. 655, 666; SMR 170-172, 206). Several new companies executed leases or agreements to the debtor or to an underlier after 1902 (R. 643, SMR 131 *et seq.*). These post-1902 companies, however, make up a relatively small portion of the track of all the companies (R. 666, SMR 206). After allowance for proposed abandonments, the total trackage of the post-1902 companies totals only 54 miles.

Since 1902 all of the property of Pittsburgh Railways Company and the underlier companies has been operated by Pittsburgh Railways Company as a unified street railway system, pursuant to the leases and operating agreements above referred to (R. 667, SMR 211 *et seq.*).

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[1] This language has been construed by the Supreme Court of Pennsylvania to pass no title to Pittsburgh Railways Company (*Second Ave. Traction Company v. United Traction Company of Pittsburgh,* 328 Pa. 257, 195 A. 25 (1937).

4. Reorganization Proceedings of Pittsburgh Railways Company, 1938 to Date

On May 10, 1938, a voluntary petition for reorganization under Section 77B of the Bankruptcy Act was filed on behalf of Pittsburgh Railways Company (R. 613, SMR 1). The petition stated that "the greater portion of the system is not directly owned but is operated by the debtor by virtue of numerous long-term leases and operating agreements and stock ownership" (R. 613, SMR 2).

The Trustees of Pittsburgh Railways Company continued to operate the property of the underlier companies, but have neither affirmed nor disaffirmed the leases and operating agreements of those companies. They have refused to make any payments of rental to the underliers, and no allowances for use and occupancy have been made. Consequently, no payments have been made on the securities of the underliers (with the exception of the "guaranteed" underliers) since 1938. The "guaranteed" companies, however, have compelled Philadelphia Company, pursuant to its guaranties of the leases of Consolidated and United, to pay the full amounts due under their leases (R. 619, SMR 32, 33). As a result, the "guaranteed" underliers are able to pay their debts as they mature (R. 631, SMR 57). All of the remaining underliers are unable to pay their debts as they mature, with the exception of six companies which were not shown to have any indebtedness (R. 631, SMR 55).

Early in the reorganization proceedings the question arose whether the debtor should pay taxes on property of the underlier companies. This question was answered

in the negative by this court in *Philadelphia Co. v. Dipple,* 312 U.S. 168, 61 S. Ct. 538, where this court said that (312 U.S. at 173) "* * * none of the lessors or underlying companies is in reorganization".

The Trustees of the debtor nevertheless prepared a plan of reorganization which contemplated that all of the companies in the system were to be brought together into a single company by a merger "pursuant to the applicable provision of the Acts of General Assembly of the Commonwealth of Pennsylvania." (R. 613, SMR 7). The plan did not contemplate that the corporate entities of the underlier companies would be ignored, but stated, to the contrary, that following the unification of operation "the separate corporate entities of the component companies were preserved" (R. 792, SMR 810).

The Trustees' plan provided that petitions for reorganization would be filed, not by all of the underlier companies, but only by twenty-five companies whose creditors and stockholders were "so many in number and so widely scattered, their unanimous acceptance of the plan cannot be anticipated." (R. 614, SMR 8).

The Pennsylvania Public Utility Commission, after rejecting certain features of the plan (38 P. U. R. (N. S.) 434; 41 P.U.R. (N.S.) 193) gave its approval to the "Amended Revised Plan" (42 P. U. R. (N. S.) 285). The Commission was not called upon to consider whether the separate operation of any of the underlier companies, or of any group of them, was physically or financially practicable, or in the public interest.

On May 23, 1942, shortly after filing their plan of reorganization on March 17, 1942, the Trustees filed a petition for a rule to show cause why twenty-five named underlier companies (those having widely scattered se-

curities) should not file voluntary petitions for reorganization (R. 614, SMR 10). In response to the Trustees' rule, six of the "guaranteed" underliers moved to dismiss the petition and none of the companies consented unconditionally to file petitions for reorganization (R. 614, SMR 11). The City of Pittsburgh then filed the petition which is the subject of the present litigation (R. 614, SMR 12).

5. The Special Master's Findings

Within the limited space of this petition, it is impossible to do more than to record a few of the more important of the Special Master's detailed findings in support of his conclusion that the City's petition should be dismissed.

The Master outlined in detail the history of the companies, and described their activities (R. 782, SMR 783-901). He further set forth the numerous instances in which the underliers had been recognized as separate corporations (R. 789, SMR 801-820).

With respect to the contention by the City that the property of the underliers and the debtor had been inextricably commingled and confused, he found that records of property had been maintained (R. 743, SMR 561-564), and concluded that "there appears to be no serious difficulty in distinguishing the debtor's property from the properties of the underliers" (R. 825, SMR 1069).

As to the accounting practices of the companies, the Master found, in the case of United and Consolidated, that there was no indication that the property originally taken over for operation by Pittsburgh Railways Com-

pany in 1902 became the property of Pittsburgh Railways Company (R. 682, SMR 301). Nor does the accounting indicate that Pittsburgh Railways Company became the owner of all the property which was added to the system after 1901 (R. 697, SMR 365).

On the question of the practicability of separate operation by the underliers, the Master found that in the event of the termination of the operating agreements running from United and Consolidated, respectively, to the debtor (and the consequent breaking of the unified operation into three separate systems, i.e., Consolidated, United and Pittsburgh) the separate operation of each of the resulting three systems would be practicable, (R. 777 *et seq.*, SMR 751, 753) but that financial difficulties would be encountered (R. 778, SMR 754). The Consolidated Traction Company System, however, would be in a much stronger financial position than would United or Pittsburgh (R. 773, SMR 731-733).

As previously noted, the Master's findings and recommendation were adopted by the District Court (R. 148 a).

6. The Circuit Court of Appeals' Decision

The Circuit Court of Appeals said (R. 943) that the question in this case "relates to the power of the court to grant the city's petition by pulling into the organization, willy nilly, the underliers." This question was answered in the affirmative, on the ground that the corporate entities of the underliers should be ignored. The Court was not deterred by the fact that it had previously held, as to these very same companies,

that corporate entities should not be ignored.[1] Referring to the concept of the "corporate veil", it said (R. 949):

> "We think a more accurate figure is that of a cloak which on some occasions is to be worn and on other occasions is to be stripped off."

The Trustee of the debtor filed a petition for clarification of the Circuit Court's Opinion. This petition raised the questions, in effect (R. 958): Are the underliers debtors in reorganization? If they are not, is the legal title to their property vested in the debtor, Pittsburgh Railways Company? If the legal title to the underliers' property is not vested in the debtor, is such property nevertheless to be dealt with for the purposes of a system-wide reorganization as if property of the debtor? The Circuit Court of Appeals denied the Trustee's petition for clarification without opinion (R. 970).

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[1] *In re Reorganization of Pittsburgh Railways Co.*, 111 F. 2d 932, 934 (affirmed, *Philadelphia Co. v. Dipple*, 312 U. S. 168, 61 S. Ct. 538), the Circuit Court had said, as to the same companies:

> "Neither the past history of the system nor the present state of the reorganization proceedings would, we think, justify our ignoring the existence of the separate legal entities which compose that system."

REASONS FOR GRANTING THE WRITS

The decision of the Circuit Court of Appeals should be brought to this Court for review, for the following reasons:

1. It is in conflict with:
   a) The decision of this Court (*infra,* p. 18),
   b) The decision of the Third Circuit in a prior case (*infra,* p. 19),
   c) The decisions of the Supreme Court of Pennsylvania (*infra,* p. 19), and
   d) The established practice in railroad reorganizations (*infra,* p. 21).

2. It presents important questions which have not, but should be, decided by this Court. These questions relate to:
   a) "Factual unity" as a basis for the exercise of bankruptcy jurisdiction (*infra,* p. 22),
   b) The disregard of corporate entities (even as between non-affiliated corporations) in reorganization proceedings (*infra,* p. 24),
   c) The status and validity of leases in reorganization proceedings (*infra,* p. 25), and
   d) The disregard of State law by bankruptcy courts (*infra.* p. 26).

Each of these reasons will be separately considered.

1. THE CIRCUIT COURT'S DECISION IS IN CONFLICT WITH OTHER DECISIONS

(a) Conflict with this Court

In a prior case arising out of the same reorganization proceedings and relating to very same companies, this Court held in *Philadelphia Co. v. Dipple,* 312 U. S. 168, 61 S. Ct. 538, that the Trustees of the debtor, Pittsburgh Railways Company, should not pay the taxes assessed against its underlier or lessor corporations. In reaching its conclusion this Court said (312 U. S. at 173):

> "* * * in the present instance, none of the lessors or underlying companies is in reorganization."

It further said (312 U.S. at 175), with reference to the business of underliers:

> "that business is not the business of the Pittsburgh Railways Company and the trustees are not the trustees of any such business".

The opinion of the Circuit Court of Appeals, we submit, is squarely in conflict with the Dipple case. If the property of the underliers may be administered as if they were in reorganization, the taxes on their property should have been paid all the while, and the Dipple case is wrong.

Furthermore, although the record in the Dipple case is not the same as the record in this case, all the facts which the Circuit Court stresses in reaching its decision in the present case (R. 946) were before it and before this Court in the Dipple case. Indeed, when the Circuit Court undertakes to consider the particulars of the case, it supports its statements with several cita-

tions of the opinion of this Court in the Dipple case (R. 946).

(b) Conflict With Prior Decision in Third Circuit

We have already noted that when the Dipple case was before the Third Circuit, that Court expressly refused to ignore the corporate entities of the underliers (*supra*, p. 16, note [1]). In the present case, on the other hand, it reaches precisely the opposite result. We submit that the Third Circuit is in conflict with itself.

(c) Conflict with Supreme Court of Pennsylvania

The opinion of the Circuit Court of Appeals is in conflict, not merely with general principles laid down by the Supreme Court of Pennsylvania, but with specific applications of those principles to the very same corporations which are the subject of the Circuit Court's opinion.

In *Second Avenue Traction Company v. United Traction Company of Pittsburgh*, 328 Pa. 257, 195 A. 25 (1937), the Supreme Court of Pennsylvania specifically held, with respect to the operating agreement from United Traction Company of Pittsburgh to Pittsburgh Railways Company that (328 Pa. at p. 259):

> "The agreement * * * was not a conveyance to Pittsburgh Company of any title of United Company in the railway lines. It was merely an agreement by which United Company turned over *possession* of the lines to Pittsburgh Company for the purpose of operation" [Italics by the Court].

Notwithstanding this decision, the Circuit Court of Appeals now rules that the property operated pursuant to

this agreement may be dealt with in the reorganization proceeding of Pittsburgh Railways Company.

In another case, *Ambridge Borough v. Philadelphia Company,* 283 Pa. 5, 129 A. 67 (1925), the Supreme Court of Pennsylvania specifically refused to ignore the entity of a street railway subsidiary of Philadelphia Company, whose status closely resembled that of the underliers in the present case. In the Ambridge case, the Court said of Philadelphia Company (283 Pa. at pp. 10, 11):

> "Its stock ownership gives it the right and the power to elect directors of its own choosing, and in this way it is undoubtedly able indirectly to impose its will in matters of management and control; *nevertheless, both subsidiary companies own their own property and franchises and their respective boards of directors are in direct management of their affairs.*" [Italics supplied].

In spite of this decision, the Circuit Court of Appeals now disregards the entities of other underliers, similarly situated.

There are other decisions of the Supreme Court of Pennsylvania which, although not involving the same companies as the present case, announce principles in conflict with the decision in this case. In *Dalton Street Railway Co. v. Scranton,* 326 Pa. 6, 191 A. 133 (1937), the Court expressly recognized the ownership of property by a lessor street railway company. In *Com. ex rel. Margiotti v. Union Traction Co.,* 327 Pa. 497, 194 A. 661 (1937) in refusing to forfeit the franchises of lessor corporations, it recognized their ownership of property. And in *Third National Bank v. Lehigh Valley Coal Co.,* 353 Pa. 185, 44 A. 2d. 571 (1945) it acknowledged the

right of a lessor to reclaim leased property in a reorganization having many points of resemblance to the instant case.

(d) Conflict with Practice in Railroad Reorganizations

The Interstate Commerce Commission, in dealing with the reorganization of railroads under Section 77 of the Bankruptcy Act, has uniformly given effect to leases of railroad properties and to corporate entities of lessors in situations comparable to the present case. In an important reorganization (*Chicago, Milwaukee, St. Paul & Pacific Railroad Company*, 239 I.C.C. 485, 534, 535) the Commission expressly refused to treat as property of the debtor, the property of a lessor company, even where 97% of the lessor's stock was owned by the debtor, its bonds were guaranteed by the debtor, and the lessor was a deficit line which could not have been profitably operated by the lessor as a separate operation. The result reached in the Milwaukee case was approved in this Court, although the question whether the Commission could have treated the properties of the lessor as part of the properties of the debtor, was not here raised. *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pacific R. Co.*, 318 U.S. 523, 546, 63 S. Ct. 727, 741 (1941). The precedent of the I.C.C. decision in the Milwaukee case was followed in the receivership of the Seaboard Air Line Railway Company (R. 831, SMR 1077).

In addition there are numerous cases illustrating the well-established practice, especially in railroad and street railway reorganizations, of making a clear distinction between leased property and owned property.

We cite the following as examples which could be multiplied many times. *Palmer v. Connecticut Railway and Lighting Co.*, 311 U.S. 544, 61 S. Ct. 379 (1941); *Thompson v. Texas Mexican Ry. Co.*, 324 U.S. 838, 66 S. Ct. 937 (1946); *Smith v. Hoboken R.R. Warehouse & S.S. Conn. Co.*, ... U.S. ..., 66 S. Ct. 947 (1946); *Pennsylvania Steel Co. v. New York City Ry. Co.*, 198 F. 721 (2 Cir., 1912); *American Brake Shoe & Foundry Co. v. New York Railways Co.*, 293 F. 633 (2 Cir., 1923); in re *Chicago Rapid Transit Co.*, 129 F. 2d 1 (7 Cir., 1942).

2. THE CIRCUIT COURT'S DECISION PRESENTS IMPORTANT QUESTIONS WHICH HAVE NOT BEEN, BUT SHOULD BE, DECIDED BY THIS COURT

The Circuit Court of Appeals has itself characterized the problem presented by this case as "very important" (R. 943). Furthermore, as the Circuit Court acknowledged, there is no judicial precedent squarely in point which would justify the result which it reached (R. 950).

(a) "Factual Unity" as a Basis for the Exercise of Bankruptcy Jurisdiction

The Circuit Court of Appeals holds, in effect, that bankruptcy jurisdiction may be extended to any corporation having "factual unity" with the debtor. This may be accomplished by the device of ignoring corporate entities as between a debtor in bankruptcy and another corporation over which bankruptcy jurisdiction is to be assumed. In the present case this is accomplished in these words (R. 951, 952):

> "We think that the many years of factual unity and the public necessity for the measures which will insure the proper economic foundation for the system, override the arguments for the recognition of the legal concept of separate entity on the part of the underliers."

The "factual unity" to which the court refers is a unity which was the result of leases duly executed by separate corporations pursuant to state law. The "unity" of a lease is converted into the unity of a merger, and the corporate entities of lessors and lessees are ignored. The "system" which is to have a "proper economic foundation" consists of several corporations, some of which are entirely able to pay their debts as they mature, others of which do not appear to have any debts, and none of which has been the subject of voluntary or involuntary petitions for reorganization. The result is that corporations which, as individuals, do not meet the requirements of bankruptcy reorganization, are treated as debtors in reorganization because they are considered to be parts of a "system" composed of several corporations which, in the aggregate, do not have a "proper economic foundation."

If bankruptcy jurisdiction may be predicated on the need for "proper economic foundations" on the part of "systems" (comprised of corporations having "factual unity"), we have a most startling and important innovation in bankruptcy law. Does the bankruptcy power of the Constitution (Art. I, sect. 8) authorize the exercise of bankruptcy jurisdiction for reasons such as these? Has Congress chosen to exercise such authority? If so, what provisions of the Bankruptcy Act evidence this intent? What is the "factual unity" which justifies such

action by the bankruptcy court? What is a "system" which must be compelled to have "proper economic foundations"? Indeed, what are "economic foundations" and when are they "proper"? These and many other questions are of the greatest importance, not only in the administration of the bankruptcy law, but in the whole field of governmental regulation of corporate activity.

(b) Disregard of Corporate Entities

This case is the first in which any court has ever disregarded corporate entities as between corporations *having no stock relationship whatever.* [1] If, as among such corporations, the corporate entity is to be "a cloak which on some occasions is to be worn and on other occasions is to be stripped off" (R. 949), the effect of such a

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[1] There is no stock relationship, direct or indirect, between Pittsburgh Railways Company or Philadelphia Company on the one hand, and the following "guaranteed underliers" on the other:

Pittsburgh and Birmingham Traction Company
Brownsville Avenue Street Railway Company
The South Side Passenger Rail Road Company
West Liberty Street Railway Company
The Birmingham, Knoxville and Allentown Traction Company.
Pittsburgh Incline Plane Company.

The same is true of the following "unguaranteed underliers":

Allegheny Traction Company
Millvale, Etna & Sharpesburgh Street Railway Company.

The foregoing examples are entirely aside from the cases of underliers whose intercompany stock control is far less than a majority, and insufficient to exercise any actual control (cf. R. 650, SMR 158).

ruling on corporations throughout the country will be of the utmost concern.

No argument is required to demonstrate the importance of corporations in the business of America, and the extent to which business men rely on their separate existence (especially as to non-affiliates having no stock relationship) as one of the postulates of business life. Consequently it is easy to visualize the dislocations and uncertainties which would ensue from the extension of the doctrine of ignoring corporate entities, to a degree so extreme, and according to principles so tenuous and obscure, as declared by the Circuit Court in this case.

(c) The Validity of Leases in Reorganization Proceedings

The effect of the Circuit Court's decision would be to call into question the validity of leases (even short-term leases which have been renewed over a number of years) everywhere in the United States. Lessors will be placed on notice that leases which have been treated as valid for many years may be stripped of the lessor's power to repossess his property, if the lessee should become bankrupt and the bankruptcy court finds that there exists "factual unity" between its property and that of the lessor.

The importance of long term leases, especially in corporate and railroad transactions, has been acknowledged by this Court. *Palmer v. Connecticut Railway and Lighting Co.*, 311 U.S. 544, 555, 61 S. Ct. 379, 382 (1941). In the field of railroads alone, there are hundreds of leases with literally billions of dollars of securities de-

pendent upon them. *Railroad Leases and Reorganization,* 49 Yale Law Journal 626 (Meck and Masten, 1940).

The status of all of these leases, and of the huge volume of securities behind the lessor companies, (not to mention the companies outside the railroad field) will be unsettled and rendered uncertain by the Circuit Court's decision. The impact of such a decision on practical affairs is too plain for argument.

(d) Disregard of State Law By Bankruptcy Courts

Aside from the disregard by the Circuit Court of the *decisions* of the Pennsylvania Supreme Court (*supra*, p. 19), we have here a disregard of the settled *legislative* policy of the state. The statutes of Pennsylvania expressly permit, even encourage, street railway corporations to do exactly what was done in this case (R. 830, SMR 1075, cf. R. 948, notes 11, 12). These statutes contain not the slightest hint that leases may be converted into conveyances, or that the corporate entities of lessors may be ignored. Yet the bankruptcy court now holds that corporate forms expressly sanctioned by the state, for a wholly intra-state street railway business, may be ignored. If this decision stands, the door will be open to an unseemly conflict between state and federal law, and to untold confusion.

Moreover, this case presents, for the first time, the proposition that a bankruptcy court may ignore state law in determining the *extent* of the property which may be administered as property of the debtor. Although it has been established that federal law governs the *distribution* of a bankrupt's property (*Heiser*

v. Woodruff ... *U.S.* ..., 66 S. Ct. 853), there had never been a case, until the present, in which state law had been ignored in determining whether a given item of property was a proper subject for distribution by the bankruptcy court.

CONCLUSION

For the foregoing reasons it is respectfully submitted that writs of certiorari should issue to the Circuit Court of Appeals for the Third Circuit.

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